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CITIZENS UTILITIES COMPANY OF ILLINOIS)
d/b/a CITIZENS WATER RESOURCES)

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Petition for a Certificate of Public Convenience)
and Necessity to provide water and sanitary)
sewer service to parcels in McHenry County,)
pursuant to Section 8-406 of the Public Utilities)
Act; and for approval of a contract.)

Docket No. 00-0194

REPLY BRIEF
OF CITIZENS UTILITIES COMPANY OF ILLINOIS

I. INTRODUCTION

As explained in Citizens Utilities Company of Illinois' ("Citizens") Initial Brief, there is no dispute that Citizens has met the requirements for a Certificate of Public Convenience and Necessity under Section 8-406 of the Public Utilities Act ("PUA"). Rather, the only issue raised by the Staff of the Illinois Commerce Commission ("Staff") in its pre-filed testimony (as well as during the hearing) is whether the Asset Purchase Agreement ("Agreement") between Terra Cotta and Citizens should be approved by the Commission, to the extent such approval is necessary. In particular, Staff argues that the Agreement is not reasonable with respect to sewer facilities because it does not provide for refunds to Terra Cotta as customers are attached. For the reasons fully set forth in Citizens' Initial Brief (at 8-11), as well as this Reply Brief, Staff's position has no legal basis and, more importantly, could be harmful to customers if adopted by the Commission. The evidence in this case conclusively establishes that the Agreement is reasonable, lawful and in the best interest of utility customers.

Although only one issue was identified by Staff during the course of this proceeding, Staff unexpectedly raised another "issue" in its Initial Brief. Specifically, Staff incorrectly asserts, without any record support, that construction of the facilities was performed "prematurely." This assertion is wrong. The evidence conclusively establishes that Citizens had nothing to do with construction of the facilities in question. Additionally, as a matter of law and policy, the Commission should disregard Staff's new assertion because it was not presented during the fact-finding phase of this proceeding.¹ Finally, because Staff did not make this factual allegation during the course of the proceeding, Citizens has not been given an opportunity to respond by presenting its own evidence; as such, consideration of Staff's assertion would violate Citizens' due process rights.²

In short, for the reasons stated in Citizens' Initial Brief and this Reply Brief, the Commission should grant Citizens a Certificate of Public Convenience and Necessity and, to the extent necessary, approve the Agreement between Terra Cotta and Citizens.

II. ARGUMENT

a. THERE IS NO BASIS FOR REQUIRING CITIZENS TO REFUND TERRA COTTA'S SEWER-COLLECTION SYSTEM INVESTMENT.

¹ See, e.g., 220 ILCS 5/10-103 (all Commission decisions must be based exclusively on the record for decision in the case); *Village of Montgomery v. Illinois Commerce Commission*, 249 Ill. App.3d 484 *8 (2nd Dist. 1993) ("As a rule, findings must be based on evidence introduced in the case, and nothing can be treated as evidence which is not introduced as such.").

² *Illinois Commerce Commission v. Operator Communication Inc.*, 281 Ill.App.3d 297, 302-03 (1st Dist. 1996).

Staff argues that the Agreement between Terra Cotta and Citizens is not reasonable with respect to the sewer facilities because it does not provide for refunds to Terra Cotta as customers are added to the system. (Staff Initial Brief at 3-4). For the reasons set forth fully in Citizens' Initial Brief (at 8-11), Staff's argument has absolutely no legal basis and, in any event, is improper from a policy perspective. As a legal matter, the Commission has rejected similar ad hoc Staff proposals in the past. Citizens Utilities Company of Illinois, Ill. C.C. Docket No. 940481, 1995 WL 612576 * 13 (1995). Neither the PUA nor the Commission's rules impose any requirement regarding financing or funding of sewer facilities, nor do Citizens' tariffs provide for refunds on sewer facilities. (Citizens Ex. 1.1 at 3-4). Indeed, it has been the Commission's longstanding practice not to require refunds for sewer facilities. Staff's attempt to impose such an ad hoc requirement retrospectively should be rejected.

Nevertheless, Staff suggests that Citizens' tariff requires refunds to be paid to Terra Cotta. (Staff Initial Brief at 5). Specifically, Staff states that "the present record offers no indication that Citizens seeks variance from its own rules." Staff, however, has misinterpreted Citizens' Section 11 - "Extension of sewer mains" (ILL.C.C. No. 5, p. 25), which is cited as support for Staff's position. This tariff provision has nothing to do with development projects such as the one at issue in this case. In fact, the referenced tariff, by its express terms, deals only with extending Citizens' facilities to serve "any single family home Customer or group of Customers *not exceeding six (6)* in number." The tariff does not apply in this case because the record establishes that the development at issue includes: a single family home development consisting of 97 single-family homes; a townhome development consisting of 170 townhomes;

and a business park consisting of 250 acres. (Tr. at 27) There are also hundreds of acres for which specific development plans are yet to be established. (Tr. 28-29; Citizens Ex. 2.0 at 4 (Khan)). Clearly, this tariff is inapplicable in this case and lends no support to Staff's assertion that Citizens should pay refunds to Terra Cotta for sewer facilities.

In addition to having no basis in law, Staff's position is improper from a policy perspective. As explained in Citizen's Initial Brief, the Agreement between Terra Cotta and Citizens was the result of arms' length negotiations between two experienced parties. Citizens Ex. 1.0 at 8 (Scheppmann). Terra Cotta and Citizens negotiated these terms over a period of time, and each party was represented by experienced business persons and legal counsel. Citizens Ex. 1.1 at 5-6 (Scheppmann). If the terms of the Agreement were not satisfactory to Terra Cotta, it could have chosen to negotiate with another utility. Citizens Ex. 1.0 at 8 (Scheppmann). Terra Cotta, however, chose not to do so.

Nevertheless, Staff attempts to substitute its judgment for that of Terra Cotta's experienced management, stating that, "Terra Cotta's advance insulates Citizens and its existing customers should residential development slow or fail, but it also ensures Terra Cotta bears most risks associated with Proposed Facilities construction." (Staff Initial Brief at 4). As a matter of policy, Staff should not be in the business of protecting the interests of developers at the expense of customers. Rather, Staff should be concerned with the welfare and prosperity of Illinois citizens who are utility customers, as contemplated by Section 1-102 of the PUA.³ The

^{3/} Additionally, Section 1-102(d)(iii) declares one goal of regulation to be that "the cost of supplying public utility services is allocated to those who cause the costs to be incurred." Citizens' agreement with Terra Cotta is consistent with this goal, while Staff's position, which

unrefuted testimony of Mr. Scheppmann indicates that approval of the contract is in the best interest of ratepayers. (Citizens Ex. 1.0 at 10-11). Moreover, as set forth in Citizen's Initial Brief, Staff's proposal would adversely affect Citizens and its customers, if adopted by the Commission. In particular, increased investment in sewer facilities would exert upward pressure on the rates charged to customers. In contrast, the negotiated Agreement with Terra Cotta will not put any pressure on rates due to increased investment. (Citizens Ex. 1.1 at 4). Staff has presented no evidence or persuasive argument to the contrary.

Staff also incorrectly asserts that the agreement allows Citizens to realize a windfall. (Staff Initial Brief at 4). Staff's argument, however, completely ignores the risks involved and the investment being made by Citizens in sewer facilities. Ironically, Staff even admits that sewer utilities have been treated differently than gas and electric utilities with respect to refunds because of the high level of investment per customer for sewer facilities (Staff Ex. 2.0 at 12 (King)); nevertheless, Staff disregards its own statement when presenting its refund proposal. Significantly, the Company's Annual Report on file with the Commission reflects \$45,895,665 in Net book *cost* of sewer facilities, clearly indicating that Citizens is making a significant continuing investment in sewer facilities. (Citizens Ex. 1.1 at 5) Moreover, Mr. Scheppmann clarified at hearing that Citizens invests (and will continue to invest) a substantial amount of money in additions, rehabilitation and improvement to the facilities that it acquires. (Tr. at 34).

It also should be noted that Staff's argument mischaracterizes the true nature of the investment made by Citizens and the assets to be acquired by Citizens. Specifically, Staff states that Citizens will acquire "\$1,439,350 of sewer collection system assets without offsetting

will inevitably create rate increases for customers, is not.

investment." (Staff Initial Brief at 4-5). This assertion is wrong. First, as noted above, Citizens will make a substantial investment in these facilities over time. Second, the \$1,439,350 figure quoted by Staff is all sewer plant, not just sewer collection facilities, as Staff now suggests. Rather, sewer collection plant amounts to \$990,212.77. (Citizens Ex. 1.1 at 5). Finally, as explained by Mr. Scheppmann, Citizens does not earn a return on the gross utility plant, but only net plant (Tr. at 34); therefore, Staff's argument is without merit, in any event.

Staff's gratuitous reference to Docket No. 00-0476 (Staff Initial Brief at 4) is far beyond the record in this case, and is entirely irrelevant. The Staff witnesses did not advance these factual assertions at any point during this proceeding, and it is far too late in the docket to do so now. *Village of Montgomery*, 249 Ill. App.3d at *8; 220 ILCS 5/10-103. Any matters regarding the purchase price of assets in another proceeding should properly be raised there, not here.⁴ And, under the schedule set in that proceeding, Staff, as well as Citizens and the other parties, will have a full opportunity to do so. This will preserve the due process rights of all parties. However, for purposes of this proceeding, Staff's argument must be ignored or rejected as inconsistent with due process and proper procedure.

Staff even goes so far as to argue: "High returns and limited liability endanger utility customers, Citizens' potentially included, providing disincentive for continued infrastructure investment and increasing inferior-service risks." (Staff Initial Brief at 4). Yet, Mr. King's own testimony directly refutes Staff's argument. Mr. King testified, "based on my experience,

⁴ Staff's belated attempt to insert Docket No. 00-0476 into this proceeding is especially troubling because Staff's attempted calculation (which is unsupported by any record evidence) appears to be erroneous.

Citizens has consistently demonstrated that they can provide adequate, reliable and efficient service to their customers.” (Staff Ex. 2.0 at 6). Mr. King further stated, “Citizens has consistently demonstrated that its water and sewer systems are well operated and its equipment is well maintained.” (Staff Ex. 2.0 at 7). Staff’s argument is also refuted by its own statement on page 2 of its Initial Brief: “Staff also finds the Company demonstrates it will provide adequate, reliable and efficient water and sewer service to customers at the Terra Cotta site.” Citizens is in complete agreement with Mr. King and Staff on these points. Moreover, Mr. Scheppmann confirmed at hearing that Citizens will continue to make substantial investments in sewer facilities. (Tr. at 34). Clearly, Staff’s arguments on Brief are completely unrelated to this case and provide no support for Staff’s ad hoc proposal.

In summary, there is no basis for requiring Citizens to refund Terra Cotta’s sewer collection system investment. The Agreement between Terra Cotta and Citizens was the result of arms-length negotiations between two experienced parties and, therefore, should not be second guessed by the Commission. More importantly, Staff’s ad hoc refund proposal is contrary to the Commission’s longstanding practices, and has no legal or policy basis. Significantly, requiring refunds of Terra Cotta’s sewer investment could adversely affect utility customers by increasing prices. For all of these reasons, the Commission should approve the Agreement between Terra Cotta and Citizens as it is currently written.

b. THERE IS NO RECORD SUPPORT FOR STAFF’S ERRONEOUS ASSERTION THAT FACILITIES HAVE BEEN CONSTRUCTED PREMATURELY.

Staff incorrectly asserts that there has been premature construction of proposed facilities before certificate issuance. (Staff Brief at 3). It is unclear who Staff believes has constructed

facilities prematurely. The important point, however, is that there is absolutely no evidence to support any assertion that Citizens has done so and, in fact, the record establishes the opposite. Specifically, the unrefuted testimony of Reed Scheppmann establishes that Terra Cotta, not Citizens, built the facilities that currently exist: "*TC constructed a 500,000 gallon elevated water storage tank, two wells, a well house, and a lift station, along with water and sanitary sewer mains.*" (Citizens Ex. 1.0 at 3-4, 7, 9; Citizens Ex. 2.0 at 5-6; Tr. 15). In fact, there is no indication that Citizens was involved in any way in the construction of facilities, or that it even knew about the facilities at any time before it entered into negotiations with Terra Cotta to purchase its existing facilities. To the contrary, when asked during cross examination whether Citizens provided any assistance to Terra Cotta in designing the water and sewer facilities, both witnesses on behalf of Citizens testified "no." (Tr. 29, 40). Staff never challenged Citizens' testimony in Staff's own testimony or during cross examination, and it stands unrefuted.

The clear focus of this proceeding has been Citizens' proposed purchase of existing facilities from Terra Cotta. (Citizens Ex. 1.0 at 5). At no time before Initial Briefs were filed did Staff mention or present facts concerning purportedly premature construction of facilities, and it is improper for Staff to do so at this late date when Citizens has no opportunity to factually respond to the allegation. Indeed, the Commission's consideration of the assertion would violate Citizens' due process rights⁵ and Section 10-103⁶ of the PUA. In any event, even if Staff had

⁵ *Operator Communication Inc.*, 281 Ill.App.3d at 302-03 (Commission failed to comply with Administrative Procedure Act when it made factual determination that carrier was violating state law without giving carrier notice and opportunity to be heard; "Due process of law is served where there is a right to present evidence and argument in one's own behalf, a right to cross-examine adverse witnesses, and impartiality in rulings upon the evidence which is offered."). Because Citizens did not have an opportunity to cross examine or respond to Staff's

properly raised this argument, the record conclusively establishes that Citizens did not construct any facilities.⁷ Obviously, if Citizens had constructed the facilities, there would be no need for Citizens to purchase those facilities from Terra Cotta, as it is proposing to do in this case.

In summary, Citizens has not built facilities "prematurely." Citizens Ex. 1.0 at 3-4, 7, 9; Citizens Ex. 2.0 at 5-6; Tr. 15, 29, 40). Staff's factual assertion that someone has prematurely constructed facilities cannot properly be considered by the Commission, as it is not part of the record in this case. 220 ILCS 5/10-103. Moreover, consideration of statements that were not sworn to or subject to cross examination would violate Citizens' due process rights. *Operator Communication Inc.*, 281 Ill.App.3d at 302-03.

III. CONCLUSION

As demonstrated in Citizens' Initial Brief and above, the Asset Purchase Agreement between Terra Cotta and Citizens is reasonable and the requirements of Section 8-406 have been satisfied. Moreover, Staff's baseless assertion that facilities were prematurely constructed is irrelevant, has no record support, and must be rejected. The Commission should grant Citizens a Certificate of Public Convenience and Necessity and, to the extent necessary, approve the Asset Purchase Agreement between Terra Cotta and Citizens in its current form.

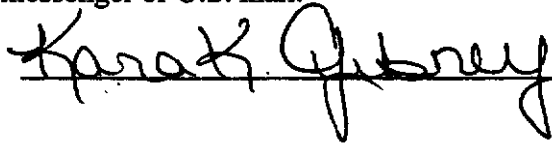
newly made allegation, consideration of the assertion would violate Citizens' due process rights.

⁶ Section 10-103 requires that the Commission's findings be based exclusively on the record. Because Staff did not make this factual allegation during the course of the proceeding, it cannot be properly considered. *See also Village of Montgomery v. Illinois Commerce Commission*, 249 Ill. App.3d 484 *8.

⁷ Of course, since Citizens received a Temporary Certificate of Public Convenience and Necessity on June 21, 2000, it could now properly construct facilities, if any were needed.

CERTIFICATE OF SERVICE

I, Kara K. Gibney, hereby certify that on this 6th day of October, 2000, I caused the foregoing Reply Brief and Proposed Order of Citizens Utilities Company of Illinois to be served on all parties listed below by either e-mail, messenger or U.S. mail.

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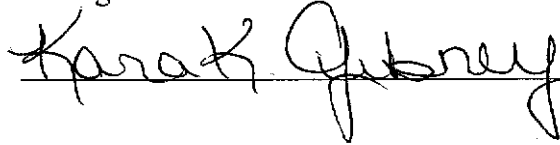
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